

ORIGINAL
OPEN MEETING
PUBLIC



0000034090

RECEIVED

410

MEMORANDUM

2005 OCT 26 P 12: 08

TO: THE COMMISSION

FROM: Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: October 26, 2005

RE: IN THE MATTER OF THE APPLICATION OF COX ARIZONA TELCOM, LLC FOR A WAIVER OF RULE 805 OF THE PUBLIC UTILITY HOLDING COMPANIES AND AFFILIATED INTERESTS RULES (DOCKET NO. T-03471A-05-0357)

Introduction

On May 17, 2005, Cox Arizona Telcom, LLC ("Cox Arizona") filed an application for an extension of the complete waiver of Public Utility Holding Companies and Affiliated Interests Rules, AAC R 14-2-805 that was granted to Cox Arizona in Decision No. 66234 dated September 16, 2003.

On June 21, 2005, Decision No. 67994 suspended this filing for a period of one hundred twenty (120) days, up to and including September 14, 2005.

On September 9, 2005, Decision No. 68115 suspended this filing for a period of sixty (60) days, up to and including November 14, 2005.

Cox Arizona is a wholly-owned subsidiary of CoxCom, Inc. CoxCom, Inc.'s parent is Cox Communications, Inc. ("Cox Communications"), a Delaware corporation headquartered in Atlanta, Georgia. Cox Communications is one of the nation's largest broadband communications companies and provides a variety of services in numerous states through the operation of a large number of subsidiaries and other affiliated companies. Those operations and services include cable television, local and long distance telephone, digital video, and high-speed Internet access. Cox Arizona (and its predecessor Cox Arizona Telcom, Inc.) has been providing competitive telecommunications services in Arizona since 1998. The revenues generated by Cox Arizona comprise less than 2 percent of Cox Communications overall revenues.

Background

In Decision No. 60285, dated July 2, 1997, the Company's predecessor, Cox Arizona Telcom, Inc., received a Certificate of Convenience and Necessity to provide intrastate competitive local exchange and resold long distance telecommunications services in Arizona.

On May 17, 2000, the Arizona Corporation Commission ("Commission") granted Cox, Cox Arizona and all of Cox Arizona's affiliates a complete waiver of AAC R14-2-805 for a 30 month period from the date of the Order in Decision No. 62582. In addition, the Commission

granted Cox, Cox Arizona and all of Cox Arizona's affiliates a partial waiver to AAC R14-2-803 ("Rule 803") and R14-2-804 ("Rule 804"). Pursuant to that partial waiver under Rule 803, Cox, Cox Arizona and all of Cox Arizona's affiliates need to file a notice of intent to enter into transactions when there is a (1) significant increase in capital costs of the Arizona operations; (2) significant additional costs allocated or charged directly to the Arizona jurisdiction; or (3) significant reduction of net income to the Arizona operations. For Rule 804, Cox, Cox Arizona and all of Cox Arizona's affiliates only need to obtain Commission approval for transactions that are likely to have a material adverse effect on Arizona operations.

On September 16, 2003, the Commission granted Cox, Cox Arizona and all of Cox Arizona's affiliates a complete waiver of AAC R14-2-805 for a 30 month period from the date of November 17, 2002 in Decision No. 66237.

Based on annual reports ending December 31, 2004, Cox Arizona generated more than \$1.0 million of Arizona jurisdictional revenue qualifying it as a Class A utility under Commission's Rules.

The Company's Request

On May 17, 2005, Cox Arizona filed an application for an extension of the complete waiver of Rule 805 that was granted in Decision No. 66234. The complete waiver of Rule 805 was limited to a thirty (30) month period from the effective date of the Decision. Rule 805 requires an annual filing of diversification activities and plans of a public utility and its public utility holding company on or before April 15th of each calendar year. In its application, Cox Arizona provided the basis for the extension of the complete waiver of Rule 805.

According to Cox Arizona, its operations represent a very small piece of the corporate structure of Cox Arizona's ultimate parent, therefore, "Cox Communications, Inc., application of Rule 805 to Cox Arizona would be unreasonably costly and burdensome"¹. Cox Arizona states that under Rule 805, Cox Arizona could be required to supply the Commission with voluminous information concerning corporate diversification activities and plans – including transactions between Cox Arizona's affiliates – and assessments of affiliate corporate structure.

Cox Arizona respectfully submits that it should continue to be exempt from Rule 805, as provided by Decision No. 66234 because (1) it operates in a highly competitive environment that, in conjunction with the Commission's existing regulatory measures, already effectively protects customers from cross-subsidization or other activities that will detrimentally affect service to customers; (2) the partial waiver of Rules 803 and 804 still require Cox to seek Commission approval for transactions or activities that have a material impact in Arizona; and (3) the Commission will continue to be able to effectively regulate Cox Arizona as appropriate in a competitive market – just as the Commission has done during the pendency of the previous waiver of Rule 805. Cox Arizona's application states in part²:

¹ Page 2, Cox Arizona, May 17, 2005 application

² Pages 3-4, Cox Arizona application, May 17, 2005

"Cox Arizona submits that application of Rule 805 to Cox Arizona and its public utility holding company continues to be both unnecessary and unreasonably burdensome. Indeed, Decision No. 66234 (line 17, page 4) noted that "The application of Rule 805 is unnecessary where a public utility company like Cox Arizona operates in a competitive environment, lacks monopoly power, and generates revenue in Arizona that represents only a small portion of its total corporate revenues."

On its face, Rule 805 would require submission of reams of information for Commission review and evaluation concerning diversification activities and plans. Along with these plans, Cox Arizona and its holding company would have to file other information including, but not limited to, financial statements for each subsidiary, a description of the plans for the utilities' subsidiaries to change business activities, an assessment of the effect of planned affiliated activities on the utility's capital structure, the bases upon which the holding company allocates costs, the dollar amount transferred between the utility and each affiliate and most contracts between affiliates and the utility. These measures are imposed, presumably, to deter any potentially negative impact on Arizona ratepayers resulting from such activities.

Cox Arizona acknowledges that such regulations are quite appropriate in the context of utilities whose revenues in large part result from the provision of intrastate monopoly utility services. Monopoly service revenues might improperly capitalize the non-regulated affiliate business activities of such utilities, with utility ratepayers both potentially bearing the risk of failure and paying higher rates than necessary for monopoly service. Such activities would unjustly burden consumers of these utility services. Under such circumstances the role of Rule 805 in monitoring non-regulated utility activities are [is] prudent and clearly serve[s] to further the public interest.

In contrast to a monopoly provider, application of Rule 805 is unnecessary where a public utility, such as Cox Arizona: (i) operates in a competitive market; (ii) does not possess monopoly power; and (iii) generates revenues in Arizona that comprises only a small portion of its total corporate family revenues and investment. Indeed, due to competitive market forces in effect in Arizona, Cox Arizona has no incentive (or ability) to charge unduly high or above-market prices that could be used to fund or subsidize unregulated affiliates or to commingle utility and non-utility funds in a manner that is harmful to Arizona consumers. Moreover, the vast majority of affiliate transactions that would need to be reported under Rule 805 are either national or pertain exclusively to interests in other states, and, therefore, have little, if any, impact on Arizona. However, if such activities do have a material impact on Arizona, Cox Arizona must still comply with Rules 803 and 804.

Finally, the requested waiver of Rule 805 has been in effect for five years now with no adverse effect on Arizona consumers. The Rule 805 waiver should continue given that lack of adverse impact, the unnecessary reporting burden Rule 805 would

place on Cox Arizona and the Commission's other existing regulatory authority over Cox Arizona."

Staff's Analysis

Cox Arizona's application seeks an extension of the complete waiver of Rule 805 that was first granted in Decision No. 62582, dated May 17, 2000, and renewed in Decision No. 66234, dated September 16, 2003. Staff's analysis was focused in three areas:

- (1) Have the market conditions fundamental to the Commission's two previous waivers of Rule 805 changed sufficiently to require that Cox Arizona now comply with Rule 805?
- (2) Have Cox Arizona's affiliate relationships changed? and,
- (3) Is a waiver of Rule 805 for Cox Arizona consistent with the Rule 805 treatment of similar companies covered by the Commission's authority?

(1) Market Conditions

When Cox Arizona was granted its 1st wavier on May 17, 2000, Cox Arizona had been in operation for approximately two years and only in limited areas of the Phoenix metro area³. When Cox Arizona was granted a 2nd wavier, its Tucson operations had just been launched⁴. Cox Arizona is now a well established Competitive Local Exchange Carrier ("CLEC") with a residence customer base in excess of [HIGHLY CONFIDENTIAL] and a statewide, residence access line market share estimated by staff of approximately [CONFIDENTIAL]. The current importance of Cox Arizona to the Arizona local exchange markets is second only to that of Qwest.

The period for which Cox was granted its previous waivers of Rule 805 also coincided with a general downturn in the national local exchange market competitive situation. During this period, major providers, such as AT&T, MCI, McLeod and Qwest, struggled financially and competitively, adding more emphasis to the importance of Cox Arizona's position within the Arizona local exchange market.

In addition to Cox Arizona's expansion within developed areas of Phoenix and Tucson metro areas, Cox Arizona's competition for new, planned developments has also been significant. Cox Arizona is known to be the primary provider in at least a dozen, planned developments in the Phoenix and Tucson metro areas. Staff notes that Cox Arizona's participation in a major planned development, Vistancia, is the subject of one proceeding, T-03471A-05-0064, still before this Commission. Cox Arizona's participation in Vistancia was, in part, driven by the actions and, perhaps, leadership of its parent and affiliate, CoxCom, Inc. At a

³ X-changemag.com, 08/1999, Phoenix Area Offers Enormous Growth Potential

⁴ Cox news release, June 23, 2003, Cox Communications Launches Cox Digital Telephone Service Throughout Tucson and Green Valley, Arizona

minimum, Cox Arizona's participation in Vistancia was heavily influenced by CoxCom, Inc. This perhaps exemplifies the affiliate actions that are the basis for concern by the Commission and led to the adoption of Rule 805 by Decision No. 56844 in March 14, 1990. How the T-03471A-05-0064 proceeding is resolved may be weighed by the Commission before reaching a determination in this proceeding.

Staff's analysis indicates that as of June 2004, 42 CLECs were providing switched access lines to end-users. The range of participation, however, appears to be quite broad. For example, the top 10 CLECs hold business main listings that equal 92.4 percent of all CLEC business main listings. The top 10 CLECs hold residence main listings that approximately equal 99.4 percent of all CLEC residence main listings. Cox Arizona is unchallenged as the No. 1 CLEC providing local exchanges services to the residence market. There are also 33 Interexchange Providers ("IXCs") and 286 Long Distance Resellers listed on the Commission's website⁵. Cox provides long distance service to end-users but is not well-known for its long distance service.

The growing importance of intermodal services to the telecommunications markets necessitates a general understanding of Cox Arizona affiliate positions in video and broadband services within the Phoenix and Tucson metro areas. Not only is Cox Communications the dominate cable video provider in Arizona, Cox Communications is also the dominant broadband provider and, as such, is a major participant in the deployment of VoIP services by many providers. While Cox Arizona is not known to be a VoIP provider, the generally strong broadband position of Cox Communications is sure to result in competitive engagement with the established local exchange market if nothing else from non-Cox affiliates deploying VoIP services using Cox Communications broadband facilities. Future broadband plans by Cox Communications and their resulting impact on Cox Arizona are of interest and concern for the Commission.

(2) Affiliate Relationships

An important focus of Staff's analysis was to understand the interdependency of Cox Arizona and its affiliates.

Staff was informed by Cox Arizona⁶ that for the year ending December 31, 2004, Cox Arizona's operations generated approximately [HIGHLY CONFIDENTIAL] of Cox Communications, Inc.'s revenues within Arizona. Cox Arizona's revenues are based on the utilization of assets under the direct control of Cox Arizona⁷ that exceed [HIGHLY CONFIDENTIAL]. Revenues that roughly equal assets would normally suggest an organization extremely effective at capital utilization. A closer view, however, indicates that Cox Arizona's operational effectiveness may be in part based on its ability to utilize assets within Cox Communications.

⁵ http://www.cc.state.az.us/utility/utility_list/IXC_list.pdf

⁶ Cox Arizona data request response to AFF 1.7

⁷ Cox Arizona data request response to AFF 1.12, as changed via email on 10/20/05.

Since Cox Arizona was unable to fully respond to Staff's third set of data requests, Staff only has a limited perspective on the operating relationship between Cox Arizona and its parent and main Arizona affiliate, CoxCom. Through responses to Staff's third set of data requests, Staff had hoped to gain an understanding of the operating dependency between Cox Arizona and its Arizona affiliates and thereby provide the Commission with some view of the corresponding operating risks. Despite the absence of critical facts, Staff believes that a disproportionate ratio of transfer payments between Cox Arizona and its affiliates probably exists based on one simple data point. Per Cox Arizona's response to data request AFF 1.12, Cox Arizona has [HIGHLY CONFIDENTIAL] within its official structure. Therefore, Staff must assume that Cox Arizona's operations depend heavily on the allocation of services and related resources from Cox Communications which has in excess of [HIGHLY CONFIDENTIAL] employees in Arizona.

Staff also notes that in its 2004 Annual Report to the Commission, Cox Arizona reported [CONFIDENTIAL] as the "Value of assets used to service Arizona customers"⁸. In its revised response to data request AFF 1.12, Cox Arizona reported in excess of [HIGHLY CONFIDENTIAL] in assets within its Arizona affiliates and states that "Those affiliate assets are used in part to provide services to Cox." Despite Staff's discovery efforts, the value of affiliated assets utilized by Cox Arizona to support its operations is not yet known and may be of considerable size.

From the available information, Staff believes that the plans of Cox Arizona have relatively minor impact on the overall operations of Cox Communications. The opposite, however, appears less true. In December 2004,⁹ the minority shares of Cox Communications were acquired by Cox Holdings and Cox Enterprises, resulting in Cox Communications and, therefore, Cox Arizona becoming 100% privately held. While this does not necessarily impact the operations of Cox Arizona, the Commission's access to information becomes further limited as exemplified by Cox Arizona's response to AFF 1.12 - "Annual reports for 2004 and 2005 unavailable due to company going private."

(3) Rule 805 Treatment

Decision No. 56844, dated March 14, 1990, first adopted the Public Utility Holding Companies and Affiliated Interests Rules found in Article 8 of the Commission's Rules. The decision¹⁰ explained that "Its [Article 8's] singular purpose is to ensure that ratepayers do not pay rates for utility service that include costs associated with the holding company structure, financially beleaguered affiliates, or sweetheart deals with affiliates intended to extract capital from the utility to subsidize non-utility operations." Stated otherwise, the objective of Article 8, and more directly Rule 805 pertaining to this matter, is to ensure that plans, activities and actions of affiliates do not include unreasonable risk that might have to be borne by the customers of entities regulated by the Commission, such as Cox Arizona.

⁸ Cox 2004 Annual Report, Telecommunications Utilities Only, page 4

⁹ Cox News Release, 12/03/04

¹⁰ D 56844, Attachment B

Staff considered the decisions involving Incumbent Local Exchange Carriers ("ILECs") and CLECs who have applied for waivers or exemptions from Rule 805.

Company	805 Waiver	Decision	Date
AT&T	Denied	56844	03/14/90
Sprint	Denied	56844	03/14/90
Qwest (USW)	Denied	58087	11/23/92
Citizens	Limited Permanent Waiver Granted	58164	02/04/93
Verizon CA (GTE/Contel)	Limited Permanent Waiver Granted	58232	03/24/93
AT&T	Denied	58258	04/08/93
MCI	Denied	58257	04/08/93
Sprint	Denied	58256	04/08/93
Arizona Telephone	Denied	58513	01/13/94
TCG	Limited Permanent Waiver Granted	60728	03/23/98
Cox	30 Mth Complete Waiver Granted	62582	05/17/00
ACSI	30 Mth Complete Waiver Granted	62616	06/09/00
MCI	30 Mth Complete Waiver Granted	62702	06/30/00
MCImetro	30 Mth Complete Waiver Granted	62702	06/30/00
Brooks	30 Mth Complete Waiver Granted	62702	06/30/00
MCI	30 Mth Complete Waiver Granted	62702	06/30/00
Qwest (USW)	Denied	64654	03/25/03
Cox	30 Mth Complete Waiver Granted	66237	09/16/03
Qwest (USW)	Denied	66612	12/09/03

As in its previous two Rule 805 waiver applications, Cox Arizona states in its most current waiver application that compliance with Rule 805 would be costly and burdensome. Cox Arizona, however, was unable to identify the cost associated with the provision of Rule 805 information stating:

"Providing this information to the Commission would require a review of all transactions between Cox Arizona Telcom and/or its parent companies (the "public utility holding companies") and all of the approximately 194 Cox affiliates to determine what relates to Rule 805 annual reporting requirements. This involves a review of all business activities, financial records, contracts and agreements for all Cox Communications Inc.'s affiliates and subsidiaries. It would then require some analysis and reporting about the potential impacts of those transactions, no matter how trivial, on Cox Arizona Telcom."¹¹

"The cost to provide this information to the Commission would be extremely difficult to quantify. In particular, the cost to provide the requested information would vary from year to year depending on the scope of responsive information available for a specific year, thus making the cost figure a constant moving target. Moreover, one must factor in all variables (such as substantial employee time in reviewing documents and preparing descriptions/summaries as contemplated by Rule 805, costs of copying relevant

¹¹ Cox Arizona's data request response to AFF 2.1

documentation, etc.) to estimate the cost to provide the Commission all of the information Rule 805 entails. To prepare a reasonable estimate of the cost of complying with Rule 805 would require Cox Arizona Telcom, LLC to perform basically the same burdensome functions it now seeks to avoid in its waiver application.”¹²

In the approximate five years since Cox Arizona was granted its 1st waiver on May 17, 2000, no effort appears to have been devoted to substantiating the primary basis for seeking relief in three separate applications. Since neither an estimate nor range of estimates has been provided in three separate applications to support Cox Arizona’s position regarding the cost and burden for compliance with Rule 805, Cox Arizona’s belief that compliance with Rule 805 is costly and burdensome cannot be based on analysis. Cox Arizona’s belief is only an assumption.

Staff’s Conclusions

Overall, Staff believes that using Rule 805 to monitor non-regulated affiliates of monopoly utility providers is prudent and in the public interest.

Although Staff recognizes that Cox does not possess monopoly power, Staff believes that Cox Arizona has become a major telecommunications provider in Arizona. In addition, in light of the Vistancia matter, Staff believes that Commission should proceed cautiously in granting a permanent waiver. Any affiliate issues that would impact Cox Arizona would impact major portions of the Phoenix and Tucson metro areas.

Cox Arizona participates in a highly competitive local exchange environment dominated by a major ILEC, Qwest. In addition, Cox Arizona is increasingly confronted with alternatives from wireless and VoIP services.

Although Qwest remains the provider of last resort as the ILEC in Phoenix and Tucson metros, Cox Arizona is known to have a dominant position in select areas, especially in new, planned developments where Cox Arizona is the preferred provider.

ILEC and CLEC entities of Cox Arizona’s main competitors – Qwest, SBC/AT&T, and Verizon/MCI – have not been granted permanent waivers of Rule 805. MCI received a 30 month waiver of Rule 805 that has expired.

Cox Arizona has been found to be in compliance and in good standing by the Compliance and Consumer Services organizations of the Commission Staff.

Cox Arizona has existing partial waivers of AAC R14-2-803 (“Rule 803”) and AAC R14-2-804 (“Rule 804”) as granted in Decision No. 62582.

Cox Arizona has been unable to substantiate its belief that compliance with Rule 805 is unreasonably costly or operationally burdensome. No cost, time or resource estimates have been

¹² Cox Arizona’s data request response to AFF 2.2

October 26, 2005

Page 9


provided. Staff generally believes that the provision of information is not as costly or burdensome as represented by Cox Arizona in its waiver application. For example, Staff believes the information that would be provided in accordance with R14-02-805A.8 is so fundamental to the financial analysis associated with the operations of Cox Arizona, that the information must be readily available. Without such information, even the simplest of Profit & Loss ("P&L") statements would not be accurate. Even the very complexities presented in Exhibit A of its waiver application give rise to questions about affiliate relationships and corresponding risks. The organizational complexities were choices made by Cox Arizona and its affiliates and, if anything, add support to the reasons the Commission instituted Rule 805.

Finally Staff notes that many companies have complied with Rule 805. In 2005, 27 companies filed Rule 805 information. Some companies provided one page responses to Rule 805. One company provided two, three-ring binders in its 2005 response. Compliance with Rule 805 does not appear to be unreasonably costly nor operationally burdensome for the companies that are responding.

Staff's Recommendations

When Cox Arizona was granted its 1st waiver in 2000, the risk presented by Cox Arizona's affiliated interests to Arizona ratepayers was minimal given Cox Arizona's limited CLEC presence. The situation has changed. Were affiliated interests to have an unexpected impact on Cox Arizona's telecommunications operations, Arizona's local exchange residence customers would be impacted in a more grievous manner than would have been possible in 2000 or 2003.

Staff hereby recommends that Cox Arizona's application for an extension of the complete waiver of Public Utility Holding Companies and Affiliated Interests Rules, AAC R 14-2-805 be denied.

for 

Ernest G. Johnson
Director
Utilities Division

EGJ:AFF:red/MAS

ORIGINATOR: Armando F. Fimbres

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 JEFF HATCH-MILLER
3 Chairman
4 WILLIAM A. MUNDELL
5 Commissioner
6 MARC SPITZER
7 Commissioner
8 MIKE GLEASON
9 Commissioner
10 KRISTIN K. MAYES
11 Commissioner

12
13 IN THE MATTER OF THE APPLICATION }
14 OF COX ARIZONA TELCOM, LLC FOR A }
15 WAIVER OF RULE 805 OF THE PUBLIC }
16 UTILITY HOLDING COMPANIES AND }
17 AFFILIATED INTERESTS RULES }

DOCKET NO. T-03471A-05-0357
DECISION NO. _____
ORDER

18
19 Open Meeting
20 November 8 and 9, 2005
21 Phoenix, Arizona

22 BY THE COMMISSION:

23 The Company's Request

24 On May 17, 2005, Cox Arizona filed an application for an extension of the complete
25 waiver of Rule 805 that was granted in Decision No. 66234. The complete waiver of Rule 805
26 was limited to a thirty (30) month period from the effective date of the Decision. Rule 805
27 requires an annual filing of diversification activities and plans of a public utility and its public
28 utility holding company on or before April 15th of each calendar year. In its application, Cox
29 Arizona provided the basis for the extension of the complete waiver of Rule 805.

30 According to Cox Arizona, its operations represent a very small piece of the corporate
31 structure of Cox Arizona's ultimate parent, therefore, "Cox Communications, Inc., application of
32 Rule 805 to Cox Arizona would be unreasonably costly and burdensome"¹. Cox Arizona states

33
34 _____
35 ¹ Page 2, Cox Arizona, May 17, 2005 application

1 that under Rule 805, Cox Arizona could be required to supply the Arizona Corporation
2 Commission ("Commission") with voluminous information concerning corporate diversification
3 activities and plans – including transactions between Cox Arizona's affiliates – and assessments of
4 affiliate corporate structure.

5 Cox Arizona respectfully submits that it should continue to be exempt from Rule 805, as
6 provided by Decision No. 66234 because (1) it operates in a highly competitive environment that,
7 in conjunction with the Commission's existing regulatory measures, already effectively protects
8 customers from cross-subsidization or other activities that will detrimentally affect service to
9 customers; (2) the partial waiver of Rules 803 and 804 still require Cox to seek Commission
10 approval for transactions or activities that have a material impact in Arizona; and (3) the
11 Commission will continue to be able to effectively regulate Cox Arizona as appropriate in a
12 competitive market – just as the Commission has done during the pendency of the previous waiver
13 of Rule 805. Cox Arizona's application states in part²:

14 "Cox Arizona submits that application of Rule 805 to Cox Arizona and its public
15 utility holding company continues to be both unnecessary and unreasonably burdensome.
16 Indeed. Decision No. 66234 (line 17, page 4) noted that "The application of Rule 805 is
17 unnecessary where a public utility company like Cox Arizona operates in a competitive
18 environment, lacks monopoly power, and generates revenue in Arizona that represents only
19 a small portion of its total corporate revenues."

20 On its face, Rule 805 would require submission of reams of information for
21 Commission review and evaluation concerning diversification activities and plans. Along
22 with these plans, Cox Arizona and its holding company would have to file other
23 information including, but not limited to, financial statements for each subsidiary, a
24 description of the plans for the utilities' subsidiaries to change business activities, an
25 assessment of the effect of planned affiliated activities on the utility's capital structure, the
26 bases upon which the holding company allocates costs, the dollar amount transferred

27
28 ² Pages 3-4, Cox Arizona application, May 17, 2005

1 between the utility and each affiliate and most contracts between affiliates and the utility.
2 These measures are imposed, presumably, to deter any potentially negative impact on
3 Arizona ratepayers resulting from such activities.

4 Cox Arizona acknowledges that such regulations are quite appropriate in the
5 context of utilities whose revenues in large part result from the provision of intrastate
6 monopoly utility services. Monopoly service revenues might improperly capitalize the non-
7 regulated affiliate business activities of such utilities, with utility ratepayers both
8 potentially bearing the risk of failure and paying higher rates than necessary for monopoly
9 service. Such activities would unjustly burden consumers of these utility services. Under
10 such circumstances the role of Rule 805 in monitoring non-regulated utility activities are
11 [is] prudent and clearly serve[s] to further the public interest.

12 In contrast to a monopoly provider, application of Rule 805 is unnecessary where a
13 public utility, such as Cox Arizona: (i) operates in a competitive market; (ii) does not
14 possess monopoly power; and (iii) generates revenues in Arizona that comprises only a
15 small portion of its total corporate family revenues and investment. Indeed, due to
16 competitive market forces in effect in Arizona, Cox Arizona has no incentive (or ability) to
17 charge unduly high or above-market prices that could be used to fund or subsidize
18 unregulated affiliates or to commingle utility and non-utility funds in a manner that is
19 harmful to Arizona consumers. Moreover, the vast majority of affiliate transactions that
20 would need to be reported under Rule 805 are either national or pertain exclusively to
21 interests in other states, and, therefore, have little, if any, impact on Arizona. However, if
22 such activities do have a material impact on Arizona, Cox Arizona must still comply with
23 Rules 803 and 804.

24 Finally, the requested waiver of Rule 805 has been in effect for five years now with
25 no adverse effect on Arizona consumers. The Rule 805 waiver should continue given that
26 lack of adverse impact, the unnecessary reporting burden Rule 805 would place on Cox
27 Arizona and the Commission's other existing regulatory authority over Cox Arizona.”
28 ...

1 Staff's Analysis

2 Cox Arizona's application seeks an extension of the complete waiver of Rule 805 that was
3 first granted in Decision No. 62582, dated May 17, 2000, and renewed in Decision No. 66234,
4 dated September 16, 2003. Staff's analysis was focused in three areas:

- 5 (1) Have the market conditions fundamental to the Commission's two previous waivers
6 of Rule 805 changed sufficiently to require that Cox Arizona now comply with Rule
7 805?
- 8 (2) Have Cox Arizona's affiliate relationships changed? and,
- 9 (3) Is a waiver of Rule 805 for Cox Arizona consistent with the Rule 805 treatment of
10 similar companies covered by the Commission's authority?

11 (1) Market Conditions

12 When Cox Arizona was granted its 1st wavier in May 17, 2000, Cox Arizona had been in
13 operation for approximately two years and only in limited areas of the Phoenix metro area³. When
14 Cox Arizona was granted a 2nd wavier, its Tucson operations had just been launched⁴. Cox
15 Arizona is now a well established Competitive Local Exchange Carrier ("CLEC") with a large and
16 growing residence customer base in the Phoenix and Tucson metro areas. The current importance
17 of Cox Arizona to the Arizona local exchange markets is second only to that of Qwest.

18 The period for which Cox was granted its previous waivers of Rule 805 also coincided with
19 a general downturn in the national local exchange market competitive situation. During this
20 period, major providers, such as AT&T, MCI, McLeod and Qwest, struggled financially and
21 competitively, adding more emphasis to the importance of Cox Arizona's position within the
22 Arizona local exchange market.

23 In addition to Cox Arizona's expansion within developed areas of Phoenix and Tucson
24 metro areas, Cox Arizona's competition for new, planned developments has also been significant.
25 Cox Arizona is known to be the primary provider in at least a dozen, planned developments in the
26 _____

27 ³ X-changemag.com, 08/1999, Phoenix Area Offers Enormous Growth Potential

28 ⁴ Cox news release, June 23, 2003, Cox Communications Launches Cox Digital Telephone Service Throughout
Tucson and Green Valley, Arizona

1 Phoenix and Tucson metro areas. Staff notes that Cox Arizona's participation in a major planned
2 development, Vistancia, is the subject of one proceeding, T-03471A-05-0064, still before this
3 Commission. Cox Arizona's participation in Vistancia was, in part, driven by the actions and,
4 perhaps, leadership of its parent and affiliate, CoxCom, Inc. At a minimum, Cox Arizona's
5 participation in Vistancia was heavily influenced by CoxCom, Inc. This perhaps exemplifies the
6 affiliate actions that are the basis for concern by the Commission and led to the adoption of Rule
7 805 by Decision No. 56844 in March 14, 1990. How the T-03471A-05-0064 proceeding is
8 resolved may be weighed by the Commission before reaching a determination in this proceeding.

9 Staff's analysis indicates that as of June 2004, 42 CLECs were providing switched access
10 lines to end-users. The range of participation, however, appears to be quite broad. For example,
11 the top 10 CLECs hold business main listings that equal 92.4 percent of all CLEC business main
12 listings. The top 10 CLECs hold residence main listings that approximately equal 99.4 percent of
13 all CLEC residence main listings. Cox Arizona is unchallenged as the No. 1 CLEC providing
14 local exchanges services to the residence market. There are also 33 Interexchange Providers
15 ("IXCs") and 286 Long Distance Resellers listed on the Commission's website⁵. Cox provides
16 long distance service to end-users but is not well-known for its long distance service.

17 The growing importance of intermodal services to the telecommunications markets
18 necessitates a general understanding of Cox Arizona affiliate positions in video and broadband
19 services within the Phoenix and Tucson metro areas. Not only is Cox Communications the
20 dominate cable video provider in Arizona, Cox Communications is also the dominant broadband
21 provider and, as such, is a major participant in the deployment of VoIP services by many
22 providers. While Cox Arizona is not known to be a VoIP provider, the generally strong broadband
23 position of Cox Communications is sure to result in competitive engagement with the established
24 local exchange market if nothing else from non-Cox affiliates deploying VoIP services using Cox
25 Communications broadband facilities. Future broadband plans by Cox Communications and their
26 resulting impact on Cox Arizona are of interest and concern for the Commission.

27 _____
28 ⁵ http://www.cc.state.az.us/utility/utility_list/IXC_list.pdf

(2) Affiliate Relationships

An important focus of Staff's analysis was to understand the interdependency of Cox Arizona and its affiliates.

Staff was informed by Cox Arizona⁶ that for the year ending December 31, 2004, Cox Arizona's operations generated a substantial amount of Cox Communications, Inc.'s revenues within Arizona. Cox Arizona's revenues are based on the utilization of assets under its direct control but are also dependent on the utilization of assets under the control of its Arizona affiliates. The level of dependency, however, is not clear from the available information.

Since Cox Arizona was unable to fully respond to Staff's third set of data requests, Staff only has a limited perspective on the operating relationship between Cox Arizona and its parent and main Arizona affiliate, CoxCom. Through responses to Staff's third set of data requests, Staff had hoped to gain an understanding of the operating dependency between Cox Arizona and its Arizona affiliates and thereby provide the Commission with some view of the corresponding operating risks. Despite the absence of critical facts, Staff believes that a disproportionate ratio of transfer payments between Cox Arizona and its affiliates probably exists based on one simple data point. Per Cox Arizona's response to data request AFF 1.12, Cox Arizona does not have all the employees needed to provide services within its official structure. Therefore, Staff must assume that Cox Arizona's operations are heavily on the allocation of services and related resources from Cox Communications in Arizona.

Staff also notes that in its 2004 Annual Report to the Commission, Cox Arizona reported a "Value of assets used to service Arizona customers" well short of its Arizona affiliate assets. In its revised response to data request AFF 1.12, Cox Arizona states that "Those affiliate assets are used in part to provide services to Cox." Despite Staff's discovery efforts, the value of affiliated assets utilized by Cox Arizona to support its operations is not yet known and may be of considerable size.

From the available information, Staff believes that the plans of Cox Arizona have relatively

⁶ Cox Arizona data request to AFF 1.7

1 minor impact on the overall operations of Cox Communications. The opposite, however, appears
2 less true. In December 2004,⁷ the minority shares of Cox Communications were acquired by Cox
3 Holdings and Cox Enterprises, resulting in Cox Communications and, therefore, Cox Arizona
4 becoming 100% privately held. While this does not necessarily impact the operations of Cox
5 Arizona, the Commission's access to information becomes further limited as exemplified by Cox
6 Arizona's response to AFF 1.12 – "Annual reports for 2004 and 2005 unavailable due to company
7 going private."

8 (3) Rule 805 Treatment

9 Decision No. 56844, dated March 14, 1990, first adopted the Public Utility Holding
10 Companies and Affiliated Interests Rules found in Article 8 of the Commission's Rules. The
11 decision⁸ explained that "Its [Article 8's] singular purpose is to ensure that ratepayers do not pay
12 rates for utility service that include costs associated with the holding company structure,
13 financially beleaguered affiliates, or sweetheart deals with affiliates intended to extract capital
14 from the utility to subsidize non-utility operations." Stated otherwise, the objective of Article 8,
15 and more directly Rule 805 pertaining to this matter, is to ensure that plans, activities and actions
16 of affiliates do not include unreasonable risk that might have to be borne by the customers of
17 entities regulated by the Commission, such as Cox Arizona.

18 Staff considered the decisions involving Incumbent Local Exchange Carriers ("ILECs")
19 and CLECs who have applied for waivers or exemptions from Rule 805.

20 ...

21 ...

22 ...

23 ...

24 ...

25 ...

26

27

28 ⁷ Cox News Release, 12/03/04

⁸ D 56844, Attachment B

Company	805 Waiver	Decision	Date
AT&T	Denied	56844	03/14/90
Sprint	Denied	56844	03/14/90
Qwest (USW)	Denied	58087	11/23/92
Citizens	Limited Permanent Waiver Granted	58164	02/04/93
Verizon CA (GTE/Contel)	Limited Permanent Waiver Granted	58232	03/24/93
AT&T	Denied	58258	04/08/93
MCI	Denied	58257	04/08/93
Sprint	Denied	58256	04/08/93
Arizona Telephone	Denied	58513	01/13/94
TCG	Limited Permanent Waiver Granted	60728	03/23/98
Cox	30 Mth Complete Waiver Granted	62582	05/17/00
ACSI	30 Mth Complete Waiver Granted	62616	06/09/00
MCI	30 Mth Complete Waiver Granted	62702	06/30/00
MCImetro	30 Mth Complete Waiver Granted	62702	06/30/00
Brooks	30 Mth Complete Waiver Granted	62702	06/30/00
MCI	30 Mth Complete Waiver Granted	62702	06/30/00
Qwest (USW)	Denied	64654	03/25/03
Cox	30 Mth Complete Waiver Granted	66237	09/16/03
Qwest (USW)	Denied	66612	12/09/03

As in its previous two Rule 805 waiver applications, Cox Arizona states in its most current waiver application that compliance with Rule 805 would be costly and burdensome. Cox Arizona, however, was unable to identify the cost associated with the provision of Rule 805 information stating:

"Providing this information to the Commission would require a review of all transactions between Cox Arizona Telcom and/or its parent companies (the "public utility holding companies") and all of the approximately 194 Cox affiliates to determine what relates to Rule 805 annual reporting requirements. This involves a review of all business activities, financial records, contracts and agreements for all Cox Communications Inc.'s

Decision No. _____

1 affiliates and subsidiaries. It would then require some analysis and reporting about the
2 potential impacts of those transactions, no matter how trivial, on Cox Arizona Telecom.”⁹

3 “The cost to provide this information to the Commission would be extremely
4 difficult to quantify. In particular, the cost to provide the requested information would vary
5 from year to year depending on the scope of responsive information available for a specific
6 year, thus making the cost figure a constant moving target. Moreover, one must factor in all
7 variables (such as substantial employee time in reviewing documents and preparing
8 descriptions/summaries as contemplated by Rule 805, costs of copying relevant
9 documentation, etc.) to estimate the cost to provide the Commission all of the information
10 Rule 805 entails. To prepare a reasonable estimate of the cost of complying with Rule 805
11 would require Cox Arizona Telecom, LLC to perform basically the same burdensome
12 functions it now seeks to avoid in its waiver application.”¹⁰

13 In the approximate five years since Cox Arizona was granted its 1st waiver on May 17,
14 2000, no effort appears to have been devoted to substantiating the primary basis for seeking relief
15 in three separate applications. Since neither an estimate nor range of estimates has been provided
16 in three separate applications to support Cox Arizona’s position regarding the cost and burden for
17 compliance with Rule 805, Cox Arizona’s belief that compliance with Rule 805 is costly and
18 burdensome cannot be based on analysis. Cox Arizona’s belief is only an assumption.

19 Staff’s Analysis

20 Overall, Staff believes that using Rule 805 to monitor non-regulated affiliates of monopoly
21 utility providers is prudent and in the public interest.

22 Although Staff recognizes that Cox does not possess monopoly power, Staff believes that
23 Cox Arizona has become a major telecommunications provider in Arizona. In addition, in light of
24 the Vistancia matter, Staff believes that Commission should proceed cautiously in granting a
25 permanent waiver. Any affiliate issues that would impact Cox Arizona would impact major
26 portions of the Phoenix and Tucson metro areas.

27 _____
28 ⁹ Cox Arizona’s data request response to AFF 2.1

1 Cox Arizona participates in a highly competitive local exchange environment dominated
2 by a major ILEC, Qwest. In addition, Cox Arizona is increasingly confronted with alternatives
3 from wireless and VoIP services.

4 Although Qwest remains the provider of last resort as the ILEC in Phoenix and Tucson
5 metros, Cox Arizona is known to have a dominant position in select areas, especially in new,
6 planned developments where Cox Arizona is the preferred provider.

7 ILEC and CLEC entities of Cox Arizona's main competitors – Qwest, SBC/AT&T, and
8 Verizon/MCI – have not been granted permanent waivers of Rule 805. MCI received a 30 month
9 waiver of Rule 805 that has expired.

10 Cox Arizona has been found to be in compliance and in good standing by the Compliance
11 and Consumer Services organizations of the Commission Staff.

12 Cox Arizona has existing partial waivers of AAC R14-2-803 ("Rule 803") and AAC R14-
13 2-804 ("Rule 804") as granted in Decision No. 62582.

14 Cox Arizona has been unable to substantiate its belief that compliance with Rule 805 is
15 unreasonably costly or operationally burdensome. No cost, time or resource estimates have been
16 provided. Staff generally believes that the provision of information is not as costly or burdensome
17 as represented by Cox Arizona in its waiver application. For example, Staff believes the
18 information that would be provided in accordance with R14-02-805A.8 is so fundamental to the
19 financial analysis associated with the operations of Cox Arizona, that the information must be
20 readily available. Without such information, even the simplest of Profit & Loss ("P&L")
21 statements would not be accurate. Even the very complexities presented in Exhibit A of its waiver
22 application give rise to questions about affiliate relationships and corresponding risks. The
23 organizational complexities were choices made by Cox Arizona and its affiliates and, if anything,
24 add support to the reasons the Commission instituted Rule 805.

25 Finally Staff notes that many companies have complied with Rule 805. In 2005, 27
26 companies filed Rule 805 information. Some companies provided one page responses to Rule 805.

27
28 ¹⁰ Cox Arizona's data request response to AFF 2.2

1 One company provided two, three-ring binders in its 2005 response. Compliance with Rule 805
2 does not appear to be unreasonably costly nor operationally burdensome for the companies that are
3 responding.

4 FINDINGS OF FACT

5 1. On May 17, 2005, Cox Arizona Telcom, LLC ("Cox Arizona") filed an application
6 for an extension of the complete waiver of Public Utility Holding Companies and Affiliated
7 Interests Rules, A.A.C. R 14-2-805 that was granted to Cox Arizona in Decision No. 66234 dated
8 September 16, 2003.

9 2. On June 21, 2005, Decision No. 67994 suspended this filing for a period of one
10 hundred twenty (120) days, up to and including September 14, 2005.

11 3. On September 9, 2005, Decision No. 68115 suspended this filing for a period of
12 sixty (60) days, up to and including November 14, 2005.

13 4. Cox Arizona is a wholly-owned subsidiary of CoxCom, Inc. CoxCom, Inc.'s parent
14 is Cox Communications, Inc. ("Cox Communications"), a Delaware corporation headquartered in
15 Atlanta, Georgia. Cox Communications is one of the nation's largest broadband communications
16 companies and provides a variety of services in numerous states through the operation of a large
17 number of subsidiaries and other affiliated companies. Those operations and services include
18 cable television, local and long distance telephone, digital video, and high-speed Internet access.
19 Cox Arizona (and its predecessor Cox Arizona Telcom, Inc.) has been providing competitive
20 telecommunications services in Arizona since 1998. The revenues generated by Cox Arizona
21 comprise less than 2% of Cox Communications overall revenues.

22 5. Decision No. 56844, dated March 14, 1990, first adopted the Public Utility Holding
23 Companies and Affiliated Interests Rules found in Article 8 of the Commission's Rules.
24 Attachment B to the Decision was a concise explanatory statement that described and explained
25 the Rules. The statement explained that "Its [Article 8's] singular purpose is to ensure that
26 ratepayers do not pay rates for utility service that include costs associated with the holding
27 company structure, financially beleaguered affiliates, or sweetheart deals with affiliates intended to
28 extract capital from the utility to subsidize non-utility operations."

Decision No. _____

1 ...

2 ...

3 6. In Decision No. 60285, dated July 2, 1997, the Company's predecessor, Cox
4 Arizona Telcom, Inc., received a Certificate of Convenience and Necessity to provide intrastate
5 competitive local exchange and resold long distance telecommunications services in Arizona.

6 7. On May 17, 2000, the Commission granted Cox, Cox Arizona and all of Cox
7 Arizona's affiliates a complete wavier of AAC R14-2-805 for a 30 month period from the date of
8 the Order in Decision No. 62582. In addition, the Commission granted Cox, Cox Arizona and all
9 of Cox Arizona's affiliates a partial wavier to AAC R14-2-803 ("Rule 803") and R14-2-804
10 ("Rule 804"). Pursuant to that partial waiver under Rule 803, Cox, Cox Arizona and all of Cox
11 Arizona's affiliates need to file a notice of intent to enter into transactions when there is a (1)
12 significant increase in capital costs of the Arizona operations; (2) significant additional costs
13 allocated or charged directly to the Arizona jurisdiction; or (3) significant reduction of net income
14 to the Arizona operations. For Rule 804, Cox, Cox Arizona and all of Cox Arizona's affiliates
15 only need to obtain Commission approval for transactions that are likely to have a material adverse
16 effect on Arizona operations.

17 8. On September 16, 2003, the Commission granted Cox, Cox Arizona and all of Cox
18 Arizona's affiliates a complete wavier of AAC R14-2-805 for a 30 month period from the date of
19 November 17, 2002 in Decision No. 66237.

20 9. Based on annual reports ending December 31, 2004, Cox Arizona generated more
21 than \$1.0 million of Arizona jurisdictional revenue qualifying it as a Class A utility under
22 Commission's Rules.

23 CONCLUSIONS OF LAW

24 1. Cox Arizona Telcom LLC is a public service corporation within the meaning of
25 Article XV of the Arizona Constitution.

26 2. The Commission has jurisdiction over Cox Arizona Telcom LLC and of the subject
27 matter in this filing.

28 3. The Commission, having reviewed the filing and Staff's Memorandum dated

Decision No. _____

October 26, 2005, concludes that it is not in the public interest to grant a complete waiver of A.A.C. R14-2-805 for an additional 30 months, retroactive to November 17, 2002.

ORDER

IT IS THEREFORE ORDERED that Cox Arizona's application for an extension of the complete waiver of Public Utility Holding Companies and Affiliated Interests Rules, A.A.C. R 14-2-805 is denied.

IT IS FURTHER ORDERED that this Decision shall be become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2005.

BRIAN C. McNEIL
Executive Director

DISSENT: _____

DISSENT: _____

EGJ:AFF:red/MS

Decision No. _____

SERVICE LIST FOR: COX ARIZONA TELCOM, LLC
DOCKET NO. T-03471A-05-0357

Mr. Michael W. Patten
Roshka Heyman & DeWulf, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

Mr. Christopher C. Kempley
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007